

STATE OF CALIFORNIA

Public Utilities Commission
San Francisco

M e m o r a n d u m

Date: July 7, 2004

To: The Commission
(Meeting of July 8, 2004)

From: Alan LoFaso, Director
Office of Governmental Affairs (OGA) — Sacramento

Subject: **AB 1647 (Jerome Horton) - Public water systems: mutual
water companies: grant funds**
As amended June 21, 2004

Legislative Subcommittee Recommendation: Support, if amended.

Summary: This bill would authorize Commission-regulated water corporations to receive state water quality grants.

Digest: Existing law, Proposition 50, the “Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002”, adopted by the voters as an initiative statute in November 2002, provides \$50 million for appropriation by the Legislature for specified water security purposes and \$435 million appropriable for specified safe drinking water purposes to DHS in the form of grants to water systems. Unlike several water quality bond measures of the past, which denied privately owned water systems from grant eligibility, Proposition 50 is silent on the use of grant funds for private public water systems (PWS). In its draft evaluation criteria, DHS takes the position that Proposition 50 funds should be available all PWS, including privately-owned.

Existing Law, Chapter 240, Statutes of 2003 (AB 1747), directed the Department of Health Services (DHS) and other participating agencies to develop grant solicitation and evaluation criteria to rank applications from PWS for the grant funds contained in Proposition 50, by March 15, 2004.

Existing law, PU Code sec. 451, requires the Commission to set just and reasonable rates for utilities

Existing law, PU Code sec. 770(b), requires that, in setting standards for water corporations, the Commission may not set standards inconsistent with the regulations and standards of DHS.

Existing law, PU Code sec. 790, provides for the disposition of net proceeds from the sale by a water corporation of property no longer necessary or useful in the performance of the corporations public duties and provides *inter alia* for the investment of the net proceeds in necessary and useful utility plant, facilities, infrastructure or other property and that such property shall be included among the utility property upon which the corporation earns a rate of return.

Existing law, PU Code sec. 851, prohibits utilities from the sale, lease, assign, mortgage or otherwise disposition of or encumbrance in whole or in part of its plant, system or property necessary or useful in the performance of its duties to the public.

This bill would authorize privately owned public water utilities that are regulated by the Commission to received Proposition 50 grants, subject to specified requirements. This bill would specifically:

1. Require Commission-regulated PWS to account for bond-financed plant as contributions in aide of construction;
2. Effectively prohibit bond-financed plant from being the source of profit by excluding it from earning a return in the ratemaking calculation;
3. Prohibit the sale or lease of bond-financed plant, while useful in the utility enterprise, except upon Commission approval; and
4. Provide that if bond-financed plant is sold when it is no longer necessary or useful, the seller must refund to the state the lesser of, either original cost minus depreciation or the net proceeds of sale.

Analysis: AB 1647 is intended to permit privately owned PWS, both mutual companies and those regulated by the Commission, to receive grants of statewide general obligation bond funds provided that said funds do not benefit any private party or entity, but rather, will benefit the public in perpetuity. In keeping with its public benefit intent, the bill:

There can be no doubt that grant funding is sorely needed by Commission-regulated PWS, especially the one-hundred twenty-seven systems with less than 2,000 service connections. With the ever increasing issues of identifying and preserving a reliable water supply, the increased cost of maintaining water quality consistent with state law and DHS regulations and the more recent addition of system security expenses, Commission-regulated PWS face the prospect of rate increases of a daunting magnitude.

There are well-established Commission decisions, rulings and standard practices that provide for the exclusion of gifts or contributions from the ratemaking methodology that incorporates the provision of profit for utilities. Similarly, the rules and decisions developed by the Commission to implement the state-financed, low-interest loans to Commission-regulated PWS from the Safe Drinking Water Bond Laws demonstrate the Commission's effective preservation of the public interest integrity of public funds.

This bill is strongly opposed by entities that object to the dramatic departure from the tradition of limiting the eligibility for government-financed grants and loans to public entities. They argue that investor owned utilities have ready access to capital markets. This assertion is clearly rebutted by the mere fact that between 1976 and 1998, 47 of the Commission-regulated PWS were granted nearly 30 million dollars in loans from the several Safe Drinking Water Bond Laws, for which eligibility depended on, among other things, the ability to prove the utility had no alternative access to capital to remedy the water quality problem. Finally, the opposition asserts that as long as public agencies are in need of funding for infrastructure needs, private water companies should not have access to the bond funds. It should not be acceptable for customers of Commission-regulated PWS to do their taxpayer duty in underwriting these funds but be deprived of benefiting from them when the needs of many of the water systems that serve them are every bit as needy as public agencies.

Recommended Amendments

This bill should be supported. However, to make it a stronger and clearer bill, it is recommended that the following amendments be incorporated into the bill to:

- (1) Require Commission-regulated utilities to specifically notify the Commission in writing of applications and receipt of bond funds;
- (2) Expressly include Commission approval of all actions as provided for in PU Code section 851, which is referenced in proposed PU Code section 2735(b)(3), relative to provisions governing treatment of bond-funded assets when they are disencumbered by the utility (instead of leaving this section limited to sales and leases of bond-financed utility plant);
- (3) Add a provision for sales by grantees of bond-financed plant that is no longer necessary or useful to the water system when the sale proceeds exceed the amount refundable to the state, requiring that the net proceeds of the sale be reinvested in utility plant and treated for ratemaking purposes as contributions in aid of construction; and
- (4) Require the Commission to establish rules and impose requirements that it determines are useful or necessary to implement the requirements and/or the legislative intent of the bill.

Specifically, the bill should be amended accordingly:

On page 4, line 5 after "Accounts." insert:

Any public water system regulated by the commission shall formally notify the commission in writing to the commission's Executive Director with a copy sent to the director of the commission's water division upon its application and upon receipt of bond funds.

On page 4, lines 10-17, amend as follows:

(3) A public water system regulated by the commission may not ~~sell or lease~~ **sell, lease or otherwise dispose of or encumber, in whole or in part,** a utility plant, **financed with grant funds** that is necessary or useful to that public water system in performing its public utility obligations except pursuant to an order of the commission in accordance with Section 851.

(4) If a utility plant **financed with grant funds** is sold and will continue to be used as part of a public water system regulated by the commission, this section applies to the entity that acquires the utility plant.

On page 4, after line 29, insert:

(6) If the net proceeds of the sale or disposition of utility plant that is no longer necessary or useful to the public water system regulated by the commission, exceeds the amount refunded to the state, pursuant to section 5 above, then grantee shall invest the remaining net proceeds in utility plant and shall account for this investment in Account 265 for contributions in aid of construction, as set forth in the commission's Uniform System of Accounts.

On page 5, after line 5, insert:

(d) The Commission shall establish rules and impose requirements that it deems necessary or useful to ensure that grant funds received by public water systems subject to its regulation are used in a manner consistent with this section and the legislative intent thereof.

Izetta Jackson of the Commission's Water Division analyzed this measure.

LEGISLATIVE HISTORY

On 6/21/04, AB 1647 was gutted and amended from a bill relating to livestock stockpond for irrigation purposes to a bill concerning grant funding for public water systems. AB 1647, as amended 6/21, was scheduled to be considered by Senate Energy on June 29, 2004; however, the hearing was postponed at the request of the author.

SUPPORT/OPPOSITION

Support: Central Basin Water Association, California Water Service Company, California Water Association, California American Water, City of Carlsbad, City of Artesia, Fontana Water Company, San Gabriel Valley Water Company.

Opposition: Association of California Water Agencies, California Coastal Commission, East Bay Municipal Utilities District.

LEGISLATIVE STAFF CONTACT

Alan LoFaso, Legislative Director
CPUC-OGA

alo@cpuc.ca.gov
(916) 327-7788

Date: July 7, 2004

BILL LANGUAGE:

BILL NUMBER: AB 1647 AMENDED
BILL TEXT

AMENDED IN SENATE JUNE 21, 2004
AMENDED IN SENATE JUNE 9, 2004
AMENDED IN SENATE MAY 28, 2004
AMENDED IN SENATE JULY 16, 2003

INTRODUCED BY Assembly Member ~~Wiggins~~
Jerome Horton
(Coauthor: Senator Alpert)

FEBRUARY 21, 2003

~~An act to add Section 1229 to the Water Code, relating to water.~~ An act to add Chapter 3.5 (commencing with Section 2735) to Part 2 of Division 1 of the Public Utilities Code, relating to water supply.

LEGISLATIVE COUNSEL'S DIGEST

AB 1647, as amended, ~~Wiggins~~ Jerome Horton
. ~~Appropriations of water: livestock stockponds~~
Public water systems: mutual water companies: grant funds .

Under existing law, generally, any person, firm, or corporation, their lessees, trustees, receivers or trustees appointed by any court, owning, controlling, operating, or managing any water system within this state, who sells, leases, rents, or delivers water to any person, firm, corporation, municipality, or any other political subdivision, whether under contract or otherwise, is a public utility, and is subject to the jurisdiction, control, and regulation of the Public Utilities Commission. Existing law authorizes a mutual water company to perform specified acts without becoming a public utility subject to the jurisdiction, control, or regulation of the commission.

This bill would provide that a public water system regulated by the commission or a mutual water company, as defined, is eligible for grant funding from the sale of any general obligation bond authorized by the voters, for the purposes stated in the authorizing bond act, unless not included or excluded by express provisions of the bond act, subject to certain conditions.

~~The Water Rights Permitting Reform Act of 1988 authorizes any person to obtain a right to appropriate water for a small domestic or livestock stockpond use, as defined, upon registering the use with the State Water Resources Control Board, as prescribed, payment of a registration fee, and application of the water to reasonable and beneficial use with due diligence. The act authorizes any registrant to change the point of diversion or place of use by delivering to the board an amended registration form, including payment of the registration fee, but prohibits a change in the purpose of the use.~~

~~This bill would provide that, for the purposes of the act, the use of a livestock stockpond for irrigation purposes does not constitute a change in the purpose of the use of the water involved, if no more than one stockpond is designated for irrigation purposes for each 50~~

~~acres irrigated.~~

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

~~SECTION 1. Section 1229 is added to the Water Code, to~~

SECTION 1. The Legislature finds and declares all of the following:

(a) More than 20 percent of all California residents receive their drinking water supply from a public water system regulated by the commission or a mutual water company. Many of these public water systems and mutual water companies serve disadvantaged communities and populations that are least able to pay for public water supply system improvements.

(b) All California residents, including those served by public water systems regulated by the commission and mutual water companies, should be entitled to participate fully in the benefits of bond measures that are passed by the voters to provide a safe and reliable water supply.

(c) Public water systems regulated by the commission and mutual water companies should be entitled to compete on an equal basis for bond proceeds that their customers help finance with their tax dollars, provided that those bond funds do not benefit any private party or entity, but rather, will benefit the public at the time they are awarded and for the entire useful life of the utility plant constructed or acquired with those bond funds.

(d) It is the intent of the Legislature to ensure that no community is barred or disadvantaged from participating in and receiving the benefits of bond measures that are passed and paid for by all of the voters on the basis of the type of public water system that provides their water service.

SEC. 2. Chapter 3.5 (commencing with Section 2735) is added to Part 2 of Division 1 of the Public Utilities Code, to read:

CHAPTER 3.5. FUNDING FOR WATER SUPPLY SYSTEM IMPROVEMENTS

2735. (a) As used in this section, the following terms have the following meanings:

(1) "Mutual water company" means a corporation formed under the General Corporation Law (Division 1 (commencing with Section 100) of Title 1 of the Corporations Code) or the Nonprofit Mutual Benefit Corporation Law (Part 3 (commencing with Section 7110) of Division 2 of Title 1 of the Corporations Code), organized for, and engaged in the business of, developing, distributing, supplying, or delivering water for irrigation or domestic use, or both, to its members or shareholders, at actual cost plus necessary expense.

(2) "Original grant basis" means the original cost of a utility plant financed with grant funds.

(b) A public water system regulated by the commission or a mutual water company is eligible for grant funding from the sale of any general obligation bond authorized by the voters, for the purposes stated in the authorizing bond act, unless not included or excluded by express provisions of the bond act, subject to all of the following:

(1) A public water system regulated by the commission that

receives grant funds shall account for all grant funds they receive for construction or acquisition of a utility plant in Account 265 for contributions in aid of construction, as set forth in the commission's Uniform System of Accounts.

(2) Consistent with the commission's ratemaking policies, the commission shall not authorize a public water system regulated by the commission to earn a rate of return on those grant funds used to acquire or construct a utility plant.

(3) A public water system regulated by the commission may not sell or lease a utility plant that is necessary or useful to that public water system in performing its public utility obligations except pursuant to an order of the commission in accordance with Section 851.

(4) If a utility plant is sold and will continue to be used as part of a public water system regulated by the commission, this section applies to the entity that acquires the utility plant.

(5) If the grantee or an entity that acquires the utility plant sells the utility plant or otherwise disposes of it, and at the time of disposition the utility plant is no longer necessary or useful to the public water system regulated by the commission, the public water system shall determine that portion of the original grant basis and refund to the state an amount equal to the lesser of the following:

(A) The original grant basis, after being reduced for depreciation in accordance with the commission's adopted useful life of a utility plant at the time the utility plant was placed in service, less the cost of removal and restoration.

(B) The net proceeds from the sale or disposition of the utility plant.

(c) Notwithstanding any provision in a mutual water company's governing instruments, including, but not limited to, its bylaws and articles of incorporation, or any provision in the Corporations Code, with respect to a mutual water company receipt of grant funds pursuant to this section, if the assets purchased, constructed, financed, or otherwise acquired with grant funds are sold, distributed, disposed of, or otherwise transferred, whether upon dissolution or otherwise, to any individual or entity that does not utilize the assets for the benefit of the public, that individual or entity shall refund to the state an amount equal to the lesser of the following:

(1) The original grant basis, after being reduced for depreciation in accordance with general accounting principles, less the cost of removal and restoration.

(2) The net proceeds from the sale or other disposition of the utility plant. ~~—read—~~

~~1229. For the purposes of this article, the use of a livestock stockpond for irrigation purposes does not constitute a change in the purpose of the use of the water involved, if no more than one stockpond is designated for irrigation purposes for each 50 acres irrigated.~~